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SUBJECT: CEARA: GETTING BY -- WITH OR WITHOUT LULA, FTAA, ET
AL

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SUMMARY

1. Ceara state had an especially bleak economic year in 2003, but with better-than-ever trade trends: exports 40% up from 2002, a record surplus, new markets, product diversity, and more small/medium-business activity. State revenues shrank, but the budget evidently stayed well-run. Jobs became fewer, and more of them shifted from the formal to the informal sector, as in Brazil nationally. Lula's Zero Hunger initiative is said to be solidly established in Ceara, which has enacted a tax hike to fund its own new social-program initiatives. As on our trips to Piaui state (Refs C, D), we got the impression that Lula's exhortations have boosted efforts at social-relief programs, even without new resources from the GoB. Conversely, officials confided that PPPs (Private-Public Partnerships, the GoB's hope for inducing private-sector investment in infrastructure) will not be viable in their swathe of Brazil's impoverished Northeast. As for tax reform: if Ceara's attitude is indicative, the GoB's proposal to simplify Brazil's basic ICMS tax into five national tiers (depriving states of the authority to set their own ICMS rates) won't soon pass. Exports to the U.S., Ceara's top foreign market for 60 years, rose in absolute terms to USD 307 million (traditional cashews and crustaceans, plus footwear, leather, "other," and even cotton), but have dropped from a 1999 peak of 54% to just 40% of the 2003 overall total. We found Ceara sentiment in favor of an FTAA to be strong, but also unbelieving. The U.S. shrimp anti-dumping petition was of great local concern.

2. Ceara shows the possibilities -- but also the hard limits -- of what can be accomplished by local government within Brazil's federal structure. On an all-Brazil scale, it may seem puny (two percent of the nation's area, four percent of population, under two percent of GDP and, even after 1991-2001 export growth, just one percent of exports.) But Ceara also looks set to stay in Brazil's pragmatic, progressive, enterprising, trade-oriented and U.S.-friendly avant-garde. It merits and should reward greater long-term U.S. cultivation.

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(END SUMMARY.)

Recession, Job Losses, State Budget

3. EconCouns re-visited Ceara state (147,000 square km, 7.5 million people) in Brazil's poverty-plagued Northeast January 19-21, meeting with state-government secretaries for Finance, Development, and Social Programs, the local Industry Chamber, private-sector executives and others. All locals said 2003 had been the toughest in memory for Ceara's economy. Its official growth figure was worse (-0.5%) than Brazil's preliminary national result (+0.3%), despite a record agricultural harvest. Recorded joblessness was up, and behind the official employment rate lies the pernicious growth trend of informal (now 51% in Ceara, it was said) vs. formal labor, as in Brazil nationally. Moreover, most informal-job growth has been in the commercial and services sectors, which the state computes is now "close to its saturation limit," said Development Secretary Regis Dias.

14. Finance Secretary Jose Mendes told us the state had had to cut public investment by 127 million Reals from a total budget of under six billion in 2003. January-September revenues were down almost 10%, year-on-year. Asked what percentage of the state budget was discretionary, he and his specialists did not know, and unconvincingly guessed "20-22%". But they eagerly reassured that, with regard to Ceara's state finances, all prime indicators (e.g., debt-to-revenue ratio; payroll share of the state budget) remain far below the ceilings allowed by the GoB's May 2000 Law of Fiscal Responsibility.

15. All lauded the GoB's success in stabilizing macroeconomic conditions in 2003, and were warily hopeful that it would produce growth in 2004. But on the micro-level they were dubious, based on state household surveys, that revived local consumption could spark any economic upswing. Last year's drop in the Central Bank's main interest rate seems to hold scant meaning for business in Ceara.

Social Welfare and Programs

16. We asked about social needs and programs. In particular: how has the 'Zero Hunger' initiative, now subsumed into the 'Family Stipend,' of Lula's GoB impacted at state level? Social Affairs Secretary Raimundo de Matos replied that state social outlays burgeoned in 2003 from 28 million per month in 2002 to 47 million, recession having increased the number of needy. 'Zero Hunger' has been installed in 174 of Ceara's 184 municipalities. Payment goes smoothly via electronic cards, realized in Caixa-Bank or post-office branches -- failing that, in national lottery-ticket outlets. Between them, these three outlets evidently cover every boondock in Brazil. We learned that since last April, local-level management of 'Zero Hunger' nation-wide has been via nine-person committees, with worker, church, mayoral and state-government representatives.

17. Secretary De Matos had ready figures for the numbers of families registered in the specific programs now being combined into Lula's national 'Family Stipend.' In all, 1.4 million families benefit from some aspect of the social-safety net. Old problems with the national "Cadastro Unico" registry have been largely resolved, he said without elaboration. Phones, fax and other hardware are the main needs now for social-program implementation, according to De Matos.

18. Officials freely referred to Ceara being Brazil's third-poorest state, behind Maranhao and Piaui. Forty-five percent of its 7.5 million population are deemed below the poverty line, defined as less than one-third of the national minimum wage per capita (i.e., 80 Reals/USD 27 per month.) This poverty is disproportionately present among the 55% of Ceara's denizens in the state's interior, away from its 100-kilometer deep coastal fringe (which generally escapes the droughts that curse the hinterland), Fortaleza and eleven other main cities.

19. Ceara has its own relief initiatives. At the end of 2003, new governor Alcantara pressed through the legislature a tax increase adding two percent to the existing ICMS tax rate on various products, as of February 1, 2004, for the 'Fund to Combat Poverty.' This tax hike was in the teeth of business opposition, all officials cheerfully volunteered. (NOTE: Eloquent of the political will involved in this step is the fact that Ceara's modern reputé for being a relative model of Brazilian progressive governance is linked to the activism of local business circles since 1973; Ref F. END NOTE.)

110. The new revenues, projected at 90-100 million Reals (USD 35 million) yearly, are earmarked for what state officials call "parallel social development." Namely, while 'Bolsa Familia' tides poor families through current difficulties, the 'Poverty Fund' is to shore up training, jobs and infrastructure for long-term self-sufficiency. Each of Ceara's municipalities is to have a "House of the Family," linked with existing offices for promoting family agriculture. Projects are to be managed by citizens' committees.

Ceara to Brasilia on Tax Reform: No Dice

111. We asked about views of the Lula administration's national tax reform: in particular, its goal of removing states' power to set their own rates for the basic ICMS tax (Ref B). Ceara has been as aggressive as any state in using this power to attract or poach industries from abroad or from Brazil's south (Ref E). Under what assurances might it cease to resist the GoB's plan to unify the ICMS rates into five national levels?

112. Finance Secretary Jose Martins' initial answer was opaque. He drew a distinction (totally lost on EconCouns) between a state setting a preferential ICMS level and granting "fiscal exemptions." But he then said outright that the GoB's proposal to form regional development funds to compensate states for the ICMS reform was unacceptable. Disposition of such funds "would be permanently in the hands of Sao Paulo and Brazil's industrialized south." This would wreck Ceara's prospects to induce foreign investment, "and without foreign investment,

whole sectors of Ceara's economy would (already) have lost competitiveness and be extinct." Other interlocutors echoed this sentiment. Bottom line: officials avoided confirming that Ceara would oppose ICMS reform, but no other logical conclusion was possible. (NOTE: Former Governor, now Senator, Tasso Jereissati has become one of Congress's key figures in the GoB's tax-reform campaign and was instrumental in putting off the ICMS issue at the end of 2003. END NOTE.)

113. What about another aspect of the GoB's tax-reform debate: the suggestion to ease constitutionally-mandated state outlays on health and education? Secretary Mendes said that item was now off the GoB tax-reform table. However, he expected it to transpire inevitably in the longer term. In his words, "the GoB Ministries of Health and Education have disappeared from Brazil's states," their mandates being transferred to state and municipal government. Ceara now spends 27-28% of its revenues on health, 10-11% on education.

Policy Imperative: Hinterland Development

114. Officials' supreme theme was the need to staunch migration from Ceara's interior to its urban littoral. Time after time, they spoke of preempting this "irreversible" process with all its sociopathic effects. Hence the state's core strategy of fostering interior "poles of development." Development Secretary Dias described the Nike factory with 1,500 workers,

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300 kilometers from Fortaleza, and of the micro-businesses ("even a bicycle dealership!") that have grown up around it. Only by being able to implant such industrial reefs can Brazil's Northeastern states abate socio-economic migration to urban favelas, was the ubiquitous view.

115. Planting new factories inland is a pre-condition to this end, but the over-arching aim is to make/keep family agriculture viable. In this regard, Ceara's huge-scale "Road of Waters" irrigation project, a series of dams, reservoirs and linking canals designed to end the region's being prey to fatal droughts (Ref F, Para 7) seems a scant-told story of much import. (COMMENT: Indeed, Northeast rural conditions illuminate why the goal of bolstering family farming ranks so high in current Brazilian policy formulation at all levels -- with all that may imply for GoB attitudes on FTAA negotiations. END COMMENT.)

116. What about the GoB's PPP initiative (Public-Private Partnership, the mechanism whereby Lula's GoB wishes to induce private investment in infrastructure projects)? Finance Secretary Martins replied that Ceara has submitted its own

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state-level bill to approve rules for PPPs. But he and others also said flatly that PPPs "are not applicable" to Ceara. Road or other public-transport concessions would not be commercially viable: volumes of use are too low. Official PPP ambitions in Ceara are for: a convention center, a family-agriculture project in the large fan of land between Ceara's most-recently completed mega-dam and Pecem port; and a smelter at Pecem.

117. NOTE: Ceara may be atypical in this respect. Since Tasso Jereissati's first election as governor in 1986, it has already benefited from World Bank, Japan ExImbank, IDB etc. financing for new ports, roads and airport on the basis of its superior governance record. END NOTE.

118. COMMENT: Ceara has been governed for almost two decades by the PSDB, which at the national level opposes Lula; yet in all our meetings there was no hint of negative assessment of Lula's PT administration -- even of shortcomings linked with Zero Hunger that have been raised by media throughout Brazil. It seemed officials could not have been more positive if they had been PT themselves. At worst, Finance Minister Mendes volunteered his worry that Lula's national administration "may simply not have a design or measures for projecting longer-term growth." Media cavils aside, it seems Lula's national standing does not yet admit of political attack. END COMMENT.

The Good News: Spectacularly Booming Trade

119. General recession notwithstanding, Ceara's decade-old export boom actually accelerated in 2003. Exports rose 40%, almost double Brazil's national increase of 21%, to USD 761 million. From 1991-1999, Ceara's total exports averaged Reals 340 million; the 2003 figure amounts to Reals 2.2 billion, at a drastically devalued exchange rate, of course. With this jump, Ceara overtook Maranhao as second largest exporter of the Northeast's nine states, behind giant Bahia, which accounts for half the region's six billion-dollar total. Coupled with a 15% drop in imports, it gave Ceara a trade surplus -- first since 1993 -- of USD 220 million. The decade's previous best result was the USD 70 million deficit/deficit of 2002. Ceara's top sectors: leather/footwear (33.5% of the total or \$255 million in 2003, up 50% from 2002); textiles (16.5%, \$125 million, up 43%); "crustaceans," i.e., shrimp and lobster (15.8%, \$112

million); and traditional cashews (14.7%, \$112 million), which as late as 1998 accounted for 40% of gross exports.

¶20. Official and business sectors alike predicted Ceara's record will only strengthen, for three reasons: variety of production; steady branching into new overseas markets; and increasing activity of small or medium enterprises. The Industry Federation (FIEC) president noted that Ceara exports more than 600 individual products, and attributed the 77% increase in the "Other Products" category in 2003 mainly to SMEs' activity. The state government's official aim is to raise the export total a further 20% in 2004. The FIEC president is boosting the goal of USD one billion in 2005.

¶21. Various contacts contrasted Ceara with Pernambuco state, which has a larger economy and superior human capital, health and education indices, but whose yearly exports are \$350 million less, and stagnant. They ascribed their neighbors' under-achievement to un-enterprising historical reliance on a sugar-cane economy. Other than with recovering Argentina, Ceara's intra-Latin-American trade is negligible. Its sights are set elsewhere, with particular apparent interest in Africa. The FIEC executive-director spoke of how a recent trade visit by six businessmen from Cape Verde, seen as a gateway to trade with West Africa ("just four hours flight from our airport," we kept hearing) reaped a million dollars of on-the spot sales.

U.S./Ceara Business

¶22. The U.S. has been Ceara's biggest market for sixty years. Through the late 1990s, cashews and crustaceans (shrimps and lobsters) accounted for 80% of all U.S. purchases, but that scenario has changed, footwear becoming the runner-up category since 1999. Sales to the U.S. have kept increasing in absolute terms, but their share of Ceara's overall exports was down from its 1999 peak of 54% to 40.3% last year. Subtotals for 2002: langostinos USD 38.5 million; shrimp 28.5 million; footwear USD 66.5 million; cashew nuts USD 58.6 million (73% of all Ceara's cashew exports); leather 26.6 million (41% of all leather exports); "others" 30.4 million. Cotton, historically the prize crop of Ceara's interior, modestly reappeared in 2003, at USD 7 million (80% thread, 20% fabric). Other main foreign markets that year: Argentina (6.7%); Canada (6.3); Holland, Spain and Italy (5.3-5.4% each). (NOTE: For many of the above categories, official state statistics vary from the local industry federation's. END NOTE.)

¶23. Conversely, U.S. sales to Ceara in 2003 dropped from 2002's \$220 million to a more historically normal \$90 million. Local recession, a huge electrical-generation sale in 2002, and the partial re-claiming by Argentina of its traditional Mercosul monopoly of Ceara's wheat market (which it temporarily vacated with its 2001 bankruptcy) seem the causes.

¶24. A February 2003 study on U.S./Ceara relations by the Governor's office calculates that from 1991 to 2002 Ceara's bilateral imports grew 482% (but see para 23 above), and its exports by 193%. Other items from the study:

-- From 1995 to 2001, ten U.S. companies, incl. Johnson Wax, Amway, and energy company ENERGISA, established operations in Ceara, generating 30% of Ceara's flow of FDI and about 2,400 jobs;

-- U.S. visitors accounted for 11% (20,000) of Ceara's foreign tourists in 2002, but have declined since the end of direct flights;

-- The report notes its concern that Ceara's ports, including Pecem, "may not have capacity to equip themselves with the machines to detect chemical and biological threats, etc, specified by new USG regulations, and that perishable local exports may thus suffer delays and loss";

-- It also deplores the discontinuation of direct flights between the U.S. and Fortaleza, ascribed to the Real's devaluation since 1999.

¶25. The Governor's Office report ends by noting "that the American Embassy in Brazil has suggested that an efficient mechanism to increase the economic interchange between the U.S. and our State would be (for) the American Department of Commerce to designate one of its officers assigned in Brazil to serve as the local promoter of US business interests in a more permanent basis. Given that the Federation of Industries of the State of Ceara (FIEC) already hosts a NUSA office, there are facilities where this officer could operate. The State government is looking forward to take whatever steps, within its scope, to make this possible."

FTAA: All In Favor, But Few Optimists

¶26. Utterances of enthusiasm for an FTAA were way up from our June 2002 visit and even from Ambassador's August 2003 visit (Refs E, F). But the common view also seemed to be that the FTAA will be decided as if by two outside parties, i.e., the USG and GoB, with Ceara's role just that of hopeful bystander.

Not that we heard any hint of discord with current GoB FTAA policy. FIEC Executive Director, who recalls two years in Arizona as the best of my life" and urged greater USDOC efforts to present American exports to Ceara, told us "I agree with both sides on FTAA," i.e., that he considers both the GoB and USG to have bogged the process down via unreasonable inflexibility on the issues of most concern to the other.

Shrimp Anti-Dumping

127. All were well-aware of the shrimp anti-dumping petition against Brazil and five other nations, the Federal Fishing Minister's January 15 call on Ambassador (Ref A), and the Minister's request that Brazil be dropped from the petition on grounds that Brazilian farmed shrimp are not subsidized, a hope widely echoed. A subsequent January 22 item in national business daily 'Gazeta Mercantil' asserted that Ceara shrimp prices and contracts have already declined in anticipation of the anti-dumping case; there was no such mention during EconCouns' visit. American investors own at least two Ceara shrimp farms. A single local middleman apparently dominates shrimp exports to the U.S.

128. The Governor's Office report on Ceara/U.S. economic relations states that the U.S. bought 80-99% of Ceara's shrimp exports from 1991-97, falling to 70% in 1999 and stabilizing at 50% since 2001. This, says the report, does not reflect a fall in North-American imports but a market diversification sought out by the Ceara industry. The nine-fold increase in shrimp exports from 1999-2002 (sic) "came from the growing use of shrimp-farming, which has allowed a dramatic expansion in supply as a result of high productivity and investments in technology." In 2002, 'Fish and crustaceans' topped the list of Ceara's exports to the U.S., at USD 67.6 million, deriving almost entirely from sales of shrimp and langostinos. In contrast to the case with shrimp, the U.S. share of Ceara's langostino exports has risen from 71% in 1991 to an average of 95% (USD 35 million) since 1997. The report also notes the U.S. Endangered Species Act and worries that if "one irresponsible fisherman is caught in a wrongdoing, the entire Ceara fishing industry ends up being unfairly punished."

A Little Local Politics

129. Ceara is famed for having been a relative model of progressive governance under continuous PSDB administrations since 1986. The PT came within a hair of capturing the Ceara governorship on Lula's coattails in the 2002 elections, however, and the tussle for primacy at city and state levels is now acute. During our June 2002 visit, local reformers excoriated the Fortaleza mayor (of the rightist PMDB party) and voiced hope he would be turned out in 2004. That mayor has since been investigated for diversion of public funds to campaign and personal use. The PT believes it can gain city hall; rumors are it will swing with other leftist parties behind city councilman Inacio Arruda of the Communist Party (PcdoB), Lula's coalition partner. Local political heavyweight Ciro Gomes, currently Lula's Minister for National Integration, might presumably follow suit. Ensuing question: will PSDB ex-thrice-governor Tasso Jereissati oppose the PT/Gomes candidate on behalf of a PSDB or PMDB alternative? The scene is further complicated by Tasso's enmity with fellow-PSDB eminent Jose Serra. Ceara politics illustrate the snarl of local dynamics that constrain Lula's efforts at national coalition-building.

Other Follow-Up (Ref E, 2002 Brasilia 2932)

130. A return call on the Jandaia fruit-juice farm/factory (a mango, cashew and passion-fruit paradise 80 km from Fortaleza) revealed a new, seven-million-dollar facility under construction. It will double Jandaia's capacity. Of the increment, Jandaia aims to export 80% to expanding markets in Europe and the U.S. Apart from a plan to gain various international certifications, the marketing strategy seemed unsure. The U.S. northeast is the first prime target area. Russia, India, China and the Middle East are not in consideration for now, but the Jandaia marketing manager was intrigued at the notion that Russian purchasing power might make it a feasible, if tough, new business zone.

131. Conversely, Ceara's new Pecem seaport, 60 km up the coast from Fortaleza, evidently remains at risk of proving an unfinished white elephant (Ref E, Para 16). State officials said the monthly number of vessel-sailings is over fifty (vs the reported 15-20 in June 2002), which does not seem much. Jandaia executives said the extra freight costs of trucking their containers of bottled and TetraPak juices to Pecem were too high to consider changing from the old port in downtown Fortaleza. Oil and fuel corporations likewise all have their existing facilities in Fortaleza. Asked if new state-highway infrastructure could supply the missing link and boost Pecem, Development Secretary Dias alluded to the old British-built, long-disused railroad into Ceara's interior dating back to days when cotton was king there -- noting that the gauge had purposely been different from that of the rest of Brazil, built to keep Ceara isolated. A regional transport net now would

have to start from scratch.

132. In Fortaleza itself (pop: 2.2 million), two shorefront hotels had been boarded-up since EconCouns's visits in 2002, and the pre-2001 hordes of Argentinian vacationers have not yet begun to reappear, but overall tourism levels were happily described as heavy, with Euro charter groups galore. Hotel staff and taxi-drivers commented on the increase of domestic, Brazilian tourists, taking for granted that the latter's numbers are up because they have become less able to afford foreign holidays.

133. U.S. tourists may be fewer, but Ceara's cashew scene is gaining an American accent. Kraft Foods/Philip Morris and other outsiders have bought up farms and processing plants, globalizing Ceara's share of Brazil's 180,000 tons of yearly cashew production (including 80% of its cashew-nut exports), according to business daily 'Gazeta Mercantil'. Brazil's main cashew commercial foe: India.

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